Global Village Space

IMF programmes, institutional quality and export performance – Omer Javed

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In 2008, the then PPP led coalition government found itself in need of obtaining foreign exchange cushion to build up country's depleting external reserves, for which it negotiated a Standby Arrangement (SBA) with International Monetary Fund. The last programme with the IMF, called the Extended Fund Facility (EFF), was negotiated in 2013 by the then PML-N government, once again with the purpose of building both foreign exchange reserves but also structural changes in economic structures so that among other aspects of aggregate supply, the one dealing with export performance could be enhanced.

Yet as the policy document of EFF indicates, the scope of such structural changes was quite narrow, since it mainly relied on government to restructure and privatize many State Owned Enterprises, including ones that dealt with power distribution. More focus, in both the programmes, 2008 (as SBA programmes do) and 2013 was basically upon improving macroeconomic discipline through a set of aggregate demand management policies; the bread and butter policy prescription of IMF; while EFF as per its design is supposed to be more focused on structural change than SBA. The result is that since 2013, the bottlenecks could not be removed for enhancing exports in the country. In fact, these bottlenecks reduced a few billion dollars since 2013 to $22 billion by 2017.

To exemplify this further- that institutional quality improvement will lead to improvement in export performance, in turn, diminishing the need for IMF programmes to build reserves from time to time, and rather a sustainable and potent way to deal with the balance of payments concerns. In this regard, I have taken a representative group of similar countries in terms of economic development, to explore the link between IMF programmes, institutional quality and export performance.

The main problem with the programme negotiated with IMF, above anything else is that it gives little importance to improvement in institutional quality, both directly and more in-depth, of a country. Actually, IMF views institutions from the perspective of orthodox economic thinking, whereby they are seen to be just composed of individuals and corporations, and that institutions grow as a consequence of economic growth.

On the other hand, heterodox economic thought, Institutional Economics to be more precise, views institutions in the broad sense of 'rules of the game', that is laws enacted to provide an environment for the organizations 'players of the game' to function efficiently. In fact, one of the leading figures in New Institutional Economics literature, Nobel Laureate, Prof. Douglas North in 1990 indicated that it is the rules and regulations that human beings establish as constraints for governing the ways they interact with each other, is what institutions are an outcome of.

Economic literature in this regard, including my own doctoral research, indicates that improvement in institutional quality positively impacts economic growth both directly, and also indirectly, through the channel of macroeconomic stability. Hence, as could be seen in economic literature, exports are directly linked with improvement in both these variables of economic growth and macroeconomic stability. Therefore, even if IMF had to improve macroeconomic fundamentals, it could only do so successfully- with sustained consequences for the economy over the long-term horizon- if it moved beyond structural adjustment and improved overall institutional quality; looking at their relevance and existence beyond the economic orthodoxy to heterodox economic thinking, that includes political institutional quality to also having a strong and positive bearing on economic fundamentals of the economy, including economic institutional quality.
Yet IMF programmes, which are kind of one-size-fits-all in nature when it comes to dealing with recipient countries, have continued to miss the link of improving institutions directly and more vigorously, and in turn on improving aggregate supply fundamentals as they are strongly affected by improvement in institutional quality. To exemplify this further- that institutional quality improvement will lead to improvement in export performance, in turn, diminishing the need for IMF programmes to build reserves from time to time, and rather a sustainable and potent way to deal with the balance of payments concerns. In this regard, I have taken a representative group of similar countries in terms of economic development, to explore the link between IMF programmes, institutional quality and export performance.

To dig further I looked at their record of IMF programmes, and it came up that only Pakistan was a prolonged or frequent user of IMF resources since 1980 (the time when IMF first actively started negotiating programmes with developing countries) among these five selected countries.

Here, to dissect further, institutional quality (IQ) is being taken in terms of economic institutional quality (EIQ) and political institutional quality (PIQ); the two important aspects of institutions. Moreover, in economic literature, Economic Freedom Index (EFI; produced by Cato Institute) is taken as a proxy for EIQ, while for PIQ is taken Polity IV (Marshall et al. dataset) as a proxy. Given the large diversity of aspects of economic institutional quality is chosen EFI as a proxy; which are government size, the makeup of the legal framework and the extent of protection of property rights, along with access to sound money, the level of liberty to trade internationally, and business, labour, and credit rules and regulations.

Also, Polity IV is chosen as a proxy for PIQ because it extensively covers the determinants of political environment; where Polity scores to be interpreted in terms of regime categories “autocracies” (-10 to -6), “anocracies” (‘regimes that mixes democratic with autocratic features’; -5 to +5 and three special values: -66, -77 and -88), and “democracies” (+6 to +10), while Polity IV consists of the following components: ‘key qualities of executive recruitment, constraints on executive authority and political competition, and changes in the institutionalized qualities of governing authority’. The set of countries include Pakistan and Bangladesh from Asia, Brazil from South America, and Nigeria and Angola from Africa, to have a well-spread country set. To dig further I looked at their record of IMF programmes, and it came up that only Pakistan was a prolonged or frequent user of IMF resources since 1980 (the time when IMF first actively started negotiating programmes with developing countries) among these five selected countries. At the same time, Nigeria was never in an IMF programme since 1980, making it the only non-IMF programme country in the group; and in turn giving a wider analytical perspective to the study at hand. The table below indicates some useful insight, which will be explained subsequently.

It is to be noted that economic literature indicates that institutional quality improves slowly over time, therefore, even data points of 2015 for EIQ and 2010 for PIQ, are quite representative of the current situation, in this regard.

Table: Exports and Institutional Quality

	Pakistan	Bangladesh	Brazil	Nigeria	Angola
Exports in 2017 ($billion; WTO*)	22	36	218	47	33
Main exports**	Textile/ Apparel	Textile/ Apparel	Transport Equipment	Petroleum/ Petroleum Products	Crude Oil
GDP per person (US$)	1,543	1,513	9,902	2,036	4,010
Import cover (months)	3.5	7.4	20.3	9.2	5.1
EIQ in 2015 (Rating)	5.93	6.32	5.75	6.38	5.40
EIQ in 2015 (Rank among countries)	127	117	137	114	148
PIQ in 2010	6	5	8	4	-2
Regime type as per PIQ in 2010	democracy	anocracy	democracy	anocracy	autocracy
IMF programme country since 1980 (1 = Yes; 0 = No)	1	1	1	0	1
Prolonged Users*** of IMF resources since 1980 (1 = Yes; 0 = No)	1	0	0	0	0

Note: *data source is World Trade Organization (WTO); source of this information is World Economic Forum; ***countries fall in the prolonged user category if they remain under an IMF programme for at least 7 years in a decade

The first major take away from the table below is that although Pakistan being a prolonged user of IMF resources in the group, has (a) the least amount of import cover when compared with other countries, which means that foreign exchange reserves could only support around 3 months of imports; should not be the case since it had been in multiple IMF programmes, where the main goal was to improve the country's balance of payments situation by putting foremost focus on enhancing foreign exchange reserves at the back improving exports, (b) the lowest level of exports among the group of otherwise all developing countries, at US$ 22 billion, and (c) has lower GDP (or more loosely national income) per person than three other countries in the group- Brazil, Nigeria, and Angola; with almost same as Bangladesh, which has not been a prolonged user.

One observation for all these developing countries that remained under IMF programmes (except Nigeria) at one point or the other is that even when they have no diversified export base; highlighting the limiting impact of structural adjustment policy milieu negotiated under IMF programmes. In the case of Nigeria, although not being in an IMF programme, but still with narrow export base, is because it remained comfortable from the huge earnings from one very big exportable in the shape of petroleum/petroleum products; serving for the country as a moral hazard, since it allowed successive governments in Nigeria, coming out of the weak political institutional quality environment with little commitment to reform, therefore continued to postpone hard economic reforms as a consequence.

In terms of PIQ, it could be seen that besides Angola, all three countries- Pakistan, Bangladesh, and Brazil- have sound democratic fundamentals, where Bangladesh and Pakistan have similar strength of democracy prevalent, while Brazil has exceedingly more sound level of democracy; and the impact of which is shown in its better position of economic fundamentals than other countries in the group.

Economic literature in this regard, including my own doctoral research, indicates that improvement in institutional quality positively impacts economic growth both directly, and also indirectly, through the channel of macroeconomic stability.

Although Autocratic, and also at the lowest level in term of EIQ (as compared to the other countries in the group), GDP per person, exports level and import cover are all performing reasonably well. The underlying reason is the availability of one highly exportable and largely available natural resource- in its case, crude oil- that allows it to perform like this. At the same time, even then it is a developing country is because both of weak PIQ and EIQ, and reliance on a very narrow export base; the last reason common to all three countries as well, but not as much as Angola, where although the other three countries (besides Angola) have otherwise better overall institutional quality.

Hence, it can be seen that long-term sustainable impact on economy, in terms of diversified export base and other economic fundamentals, comes from strong institutions at the back of committed governments doing hard economic reforms, for which is needed institutional reform in the wider/heterodox sense, and not some structural adjustment as per the Neoliberal policy milieu of public policy both independent and that comes in the shape of negotiated IMF programmes.